

## **Community Economic Development, Community Development Finance: Introducing the Terms – Exploring the Relationship**

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How the two terms, community economic development and community development finance, are defined is crucial to the design and construction capacity, whether the aim be to revitalize particular territories or to create a supportive base for social enterprise development, for example. What the terms are thought to entail will set the fundamental direction. This paper sets out what is generally accepted as the connotation of these terms and the particular principles that appear to underlie the most effective organizations in CED and its finance.

### **Community economic development**

In briefest terms, CED is a comprehensive system of development, under local control and direction, to create long-term new resources that enhance the locality as a place to live and work. (Note: “resources” here means financial, social, human, physical, and business resources.) The notion of comprehensiveness and system are critical. CED is not just one technique (say, business development) or even a set of techniques (say, a set of financing tools for local initiatives); it is instead a wide-ranging strategy comprised of sets of techniques or tools, including social, psychological, political, and economic mobilization. And the effectiveness of any selected techniques is increased by the fact that they are deployed in such a way as to reinforce the impact of each of them.

The basic insight of CED, an insight that entails a comprehensive system of both social and economic initiatives, is that distressed communities are not handicapped by one particular problem (say, a paucity of jobs) but by an interacting complex of problems which reinforce the destructive power of each. Thus it is not enough to create a new venture for a set of new jobs, if the physical infrastructure is insufficient to serve that venture; it is not enough to improve the physical infrastructure, if public safety is at risk; it is not enough to heighten police protection, if the housing stock is deteriorated; and it is not enough to build new housing, if the residents do not have a hope of a better existence beyond their housing, and so on.

Naturally, not every problem can be addressed at the same time or with the same energy or resources by any one organization. Thus CED absolutely requires partnering and collaboration among the whole set of significant sectors, organizations, and population groups. And each locality has its own most pressing problems; setting priorities for addressing them is the task of local direction, which must also find the resources for that purpose.

The local task of setting priorities, detailing implementation, assembling resources, building partnerships, and executing an action plan ordinarily requires a specialized

organizational tool or lead group. Commonly, this has come to be termed a Community Development Corporation or CDC.\*

### **Lutherwood CODA: A Rich Set of CED Programs**

Lutherwood CODA, in the Waterloo region, fields the most diversified set of CED programs in the country. They range from housing for seniors to reading programs for children; from several specialized loan funds to business career counseling; from an integrated array of employment services to new businesses that serve as a training context. They also were one of the first to experiment effectively with Individual Development Accounts.

Perhaps the most ambitious of their projects was one that ultimately drew a United Nations award: A massive effort (OP 2000) begun in 1998 to mobilize banks and businesses, nonprofit community groups and government agencies to bring 2000 families out of poverty by the end of the year 2000. It was based on a previous public-private-nonprofit initiative that had helped over 1000 welfare recipients find jobs or start self-sustaining businesses and 1000 more enter educational and training programs. For its part, OP 2000, aside from its success in moving people from welfare/poverty, has created a continuing network of dozens of capable community organizations that are mobilized and working on all the varied problems of poverty in the Waterloo area. Lutherwood CODA has built a community to eradicate local poverty.

Probably the first CDC in Canada was started in Cape Breton, Nova Scotia, incorporated in 1976 as New Dawn Enterprises Ltd. It grew out of a housing development cooperative which determined that addressing the deterioration of the Cape Breton economy needed a more comprehensive approach than simply creating affordable housing. New Dawn has continued to emphasize housing development (currently at the \$20 million mark in assets), but it also engages in business creation, health services, training, and other supportive activities. Its projects usually involve more than one activity, so that, for example, a new business will have health services as its focus, or perhaps industrial training. Because the provision of capital is a significant factor in CED, New Dawn has also tried a variety of approaches for that. Currently it is a partner with BCA, a community development finance group that it helped to launch.

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\* We will also use a more generalized terminology—i.e., CEDO (community economic development organization) for all such structures.

### **Quint Development Corporation: Using Partnerships**

Five of Saskatoon's poorest neighbourhoods created Quint in 1995 to revitalize their area. Their first major initiative addressed the problem of under-maintained absentee-owned housing and high residential turnover. Through a subsidiary co-op, ten houses were purchased to be eventually bought by ten low-income families (especially, young families with children and with, importantly, a record of rental responsibility), who would plant roots and help stabilize the area. Another co-op was established for them (and others) to learn homeownership and maintenance skills. This pilot was so successful that Quint has since established six similar housing co-ops.

Among the partners were the province (25 percent forgivable loan), the city (5 percent grant), two credit unions (70 percent non-guaranteed mortgages), the provincial crown corporation for employment (building inspections), the real estate company (commissions contributed to a management fund), private firms and cooperatives (discounted building supplies and legal and appraisal services), and others for help in developing a training program for those who would be doing the renovations.

Other projects with other partners are two micro-business loan funds, business training and support programs, co-housing for high school student single mothers, a hostel for homeless young men, and an energetic support and facilitation effort for other CED groups in Saskatoon.

But each community has its own structures for carrying out CED functions, and these will vary according to local history and needs. In some smaller towns, the structure may be a municipal agency of some kind, but ordinarily it is a nongovernmental group that tries to partner with government at all levels.

## **HRDA Enterprises Ltd: Creating Businesses, Dollars, Jobs**

For over 20 years, HRDA Enterprises in Halifax and its nonprofit parent (Human Resources Development Association) have built profitable businesses and trained people from the welfare rolls to take jobs in those businesses (at wages higher than welfare checks). By this time, many of the original welfare recipients are now part of the managerial teams in those businesses. Many others are working in the private sector.

The Halifax welfare department was crucial for this self-sustaining initiative. It offered a capital grant equivalent to one-year's welfare costs for each successful recipient. To make this work, HRDA uses appropriate training and social supports for the job-holders, as well as a careful feasibility, investment, and management process to create and run the businesses. While any private firm in Halifax can receive the same grants, none has successfully done so, because they do not integrate the essential social techniques of a comprehensive community development corporation.

Naturally, HRDA has had its business failures. But this community organization has maintained an overall profit record. Moreover, careful research has documented that for every \$1 granted, the province/city have received back \$1.80 in taxes paid and welfare costs avoided. This, of course, does not encompass all the human and social benefits from HRDA's work.

A full-fledged CEDO will be recognized by a wide range of established activities, especially:

- It builds equity assets in its own enterprises as well as in others in the community.
- It fosters access to credit (and sometimes to equity capital) for local businesses, especially through its own investment and lending programs.
- It strengthens the human resources of its community—those skills needed for either income-earning activities (for jobs or successful business management) or for leadership in its own organization or in the community in general.
- It carries out planning, research, and advocacy work (including building partnerships).

These four sets of activities characterize a mature development system. Building the community capacity for carrying out CED is obviously a pre-requisite to that comprehensive system

Some communities do not have such a lead group at all, while in others the group, though perhaps in existence some years, is not strong. In these settings, the CED activities (of human resource development, of housing development, of business development, of finance development, etc.) are not well coordinated or put to the most effective use.

### **Community Development Finance**

Community development finance is the provision of capital (in either equity or credit formats) for CED purposes, and it can include any related activities that enhance the return or reduce the risk to the capital. Thus, for example, it can include facilitating training in business planning and business management for those borrowers who are using the funds for a venture start-up. The reason that the CED financing function must include some set of related activities is that, by definition, it specializes in gap financing for target projects that commonly do not find the necessary capital from conventional sources—and, again, by definition those projects ordinarily are not strong enough on their own and must have supportive services.

Of course, community development finance (CDF) requires an institutional format by which the finance is deployed. This format can range from a large and comprehensive banking operation with many different capital products and supporting programs (like South Shore Bank) to, say, a very small organization with a single limited service such as the provision of loan guarantees for workers buying a share in a co-op. In any instance, the CDF institution, like any CEDO, will always have to depend upon collaborative relations with other organizations—in order to provide capital in the most productive fashion. Clearly, for example, a worker co-op loan guarantee fund will rely upon another institution to provide the loans that it will be guaranteeing; and with that or another partner it will have to assure that the borrowers are adequately trained and supported for the type of business concerned and for sharing in the direction of that co-op business. Similarly, the commercial loan operation of a comprehensive development bank must assure that even its better prepared borrowers have ready access to technical assistance on business problems they will encounter after receiving the loan.

### **South Shore Bank: Taking on the Impossible**

In 1973 a group of activists, only one of whom had experience in banking, bought the South Shore Bank, a small Chicago neighborhood bank, to turn it into a community development tool for a mainly black district of 75,000 population that was threatening to decline into a spiraling deterioration. Encumbered by a highly leveraged position, the bank struggled for years to make a profit, but its eventual success in promoting a community-building program of local business, personal, and mortgage loans in a variety of formats, together with its own equity investments, led an American president to create an on-going multi-million-dollar annual program to foster a variety of related “Community Development Finance Institutions” throughout the United States.

For its part, South Shore transformed itself into a holding company, Shorebank, and created a set of subsidiaries to do the supporting tasks for the core institution. These include the Neighbourhood Institute to provide technical assistance and an incubator for local business; a real estate property development company; and a nonprofit social-development organization. Over the years Shorebank has moved into other neighborhoods, other states, and it has helped launch an independent bank to serve Arkansas and the Mississippi Delta region.

Rarely, if ever, would a CDF institution by itself provide all the penumbra of activities necessary to its financing operations. Just as any CEDO will rely upon partners because it cannot do the whole job by itself, so too the CDF institution will be dependent upon specialized collaborators.

Within this framework, then, a credit union is not necessarily a CDF institution: If it merely provides financial services to persons who could receive the same services elsewhere, it is not engaged in gap financing. Yet it is clear that credit unions historically arose precisely to provide such gap services, and so they were (and most often continue to be) community development finance institutions, albeit usually with a very limited functional armory. Recall that CED is a comprehensive development system; so, similarly, furnishing capital must be equally elaborated into many different products and services in order to systematically underwrite the CED process.

To repeat, this does not mean that any one CDFI must or does carry out every financing function necessary for CED. It does mean that to be most effective any organization engaged in the financing of CED must recognize that the complexity of development

requires a complex of financing functions, to be created and used in the service of enhancing the community as a place to live and work.

It is useful to illustrate The credit union that is limited to offering personal and mortgage loans for some particular cohort of those who would never be able to access adequate credit elsewhere is doing an important but limited part of the job. What others are still not being served? And even if the credit union also offers one or more types of business financing, it may still be restricted in its potential impact because of other financing gaps in the community fabric. However, if the credit union (for reasons of liquidity, say) cannot offer some essential types of financing, it may still perform an additional service through establishing partnerships with other CDFIs in order to fill those gaps. Such a credit union is engaged in the business of CED, although it is using only the one set of techniques, community development finance, in the service of CED.

### **BCA Holdings Ltd.: Community Venture Capital**

BCA was organized in 1989 by local activists and businesspeople as a free-standing nonprofit institution to finance new or established local ventures that would contribute to the social and economic stability of Cape Breton communities. It had a very small capital base, until stimulated by the offer of a no-interest government loan of \$500,000, when it raised another \$500,000 from fellow Cape Bretoners. The private capital is borrowed in various formats but receives only five percent interest annually. Most of the work is done by members of a small volunteer board of directors, with only one part-time professional staff person, who has a junior assistant. Investments are made primarily by way of secured loans at close to market rates. However, BCA Investment Cooperative, a partner organization, was capitalized more recently at \$730,000 to take advantage of provincial tax incentives; and it makes only equity investments.

Among the business deals of the BCA group are a radio station, a small hotel/restaurant, an immensely successful rope factory, and a small shopping plaza. Aside from creating jobs and assuring local services, BCA aims especially to prevent the loss to outside investors of any local firms, so it requires at least two local owner-operators for each of its projects.

As suggested before, gap financing is apt to be higher in risk and lower in return. Thus the very purpose of the CDFI (to strengthen the community by bridging those gaps) can challenge the ingenuity of managers to maintain the basic viability of the CDFI. Managing this tension between institutional survival and the primary purpose is the

source of most of the key issues in community development finance. These issues (and some of the common techniques for addressing them) include:

1. How to target investments for the greatest impact (that is, how to use available capital for the greatest socio-economic effect in the community)—e.g., by carefully constructing the CDFI strategic plan; and/or by efficiently targeting selected, specified market needs or types of investment.
2. How to reduce the risk in an investment—e.g., by carefully structuring it so that the project can reasonably handle the price of the capital; by careful and close, even on-site, monitoring; by providing or arranging for technical assistance; and/or by sharing the investment with other financiers.
3. How to increase the return from an investment—e.g., by making sure that it is not under-priced; and/or by taking on the role of project developer in order to generate other sources of revenue from the investment.
4. How to decrease the burden of the transaction costs in the investment process—e.g., by accessing sources of subsidies; and/or by passing on transaction costs to the client projects.
5. How to actually decrease the costs themselves—e.g., by cuts in variable expenses; by assuring low turnover in competent staff; by on-going staff training; and/or by specializing in particular investment types so as to become more expert in handling them.
6. How to access additional capital to offset losses—e.g., by increasing the attractiveness of the return to investors in the institution; or by increasing capital recruitment efforts; and/or by partnerships with loan loss guarantors.

The illustrative techniques mentioned here are unexceptional, although they must be adapted or adopted according to local conditions. Ultimately, managing the tension between sustainability and community impact involves the creative design and use of new products or services that close a financing gap in the community and at the same time produce cost-offsetting revenues and even surpluses. That in the end is the keystone in the practice of development finance.

### **Best Practices**

Organizations that have CED or CDF as their mission take many different forms, as has been suggested. Yet there are principles of structure and function that stretch across the varying formats and that appear to presage a higher degree of effectiveness, compared to those organizations that do not include such principles or features. These, for want of a better term, we call here “best practices.” It is true that some organizations that do not evidence each such practice may indeed successfully perform important functions for their communities, especially when there are complementary institutions at work. What



we outline here, however, is derived from the investigations and observations of many different practitioners and researchers in the field as most likely to predict success.

### Features of the Effective CEDO

The CEDO that is apt to have the most impact upon its community (an impact that is nevertheless qualified and restricted, of course, by the decades of deterioration that the community has suffered) will have the following features\*:

- A multi-functional, comprehensive strategy or development system of on-going activities, in contrast to any individual economic development project or other isolated or unrelated attempts at community betterment;
- An integration or merging of economic and social goals to make a more significant impact for community revitalization;
- A base of operating principles that empower the broad range of community residents for the governance both of their development organizations and their community as a whole;
- A businesslike financial management approach that builds both ownership of assets and a diverse range of financial and other partners and supporters; and finally,
- An organizational format that is non-profit, independent, and non-governmental, even when for-profit and governmental entities are linked to its work.

To repeat, while a single organization within any one locality may exhibit these features, that is not the only format in which CED may be effectively carried out. The system may, in fact, be the result of coordinated activities of a group of organizations. The Enterprise Centre of Revelstoke, organized in 1986, is an illustration. It is the joint product of the municipal department of economic development, the local Community Futures Development Corporation, and the local Chamber of Commerce. And even so, the system required establishing still another organization a few years later, the Revelstoke Community Forest Corporation, another local organizational element for community renewal. In short, the principles may be embodied in a coordinated set of organizations, rather than in one single organization.

### Features of the Effective CDFI

The credit union as a development finance institution is, of course, a cooperative, and as such there have been quite definite features specified for its most effective operation, as a cooperative. However, development finance, as has been described here, can be carried out in other formats that do not involve the co-op structure. What is presented here as best practice extends across the different formats, both co-op and other. There are

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\* This is derived from *Tools and Techniques for Community Renewal and Recovery* (Centre for Community Enterprise, November 2000), which is comprised of extended descriptive entries on some 40 individual CED techniques.

perhaps a dozen features that characterize the effective CDFI (or the effective CDF program in a more differentiated institution, a CEDO):\*

1. Those who are clear about their targets, about what they are trying to accomplish, will have an easier time balancing the conflict between community needs and their institutional sustainability.
2. The CDFI is more likely to be effective if its services are offered as part of a comprehensive development strategy.
3. Cooperative and pooled efforts will enhance the reach and effectiveness (impact) of what the CDFI does.
4. The CDFI does better if it pays close attention to pricing its services: That is, by making any subsidies quite explicit in its operations, it can tailor them to the social and financial returns it seeks.
5. Bankable deals can sometimes be assured by offering prospective clients technical assistance, and success in the deal may also depend upon technical assistance after financing. The CDFI has to be prepared to offer both kinds of technical assistance or arrange for them to come from a partner; but being proactive in that way does not mean making clients dependent, or forsaking other markets.
6. Sometimes the CDFI has to be the developer. That is, when there are no potential clients for a key project in the target community, the CDFI will have to take the initiative to create the project. This may mean merely bringing community people together to design and carry it out, or it may mean actually doing all these tasks itself.
7. The CDFI will more likely survive if it targets its services for the greatest impact. The capital and the subsidies are best reserved for projects that will make a bigger difference.
8. To ensure survival, the CDFI may have to make some lower-risk investments that might have been approved by some other institution.
9. Managing risk is central to survival and so it is necessary to figure out ways to do this best in each deal. And as with any financial activity, portfolio diversification is a prime means of risk management.

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\* That is, CDF may be observed as simply one set of techniques utilized by a more comprehensively elaborated organization.

10. Sources of revenue will be varied; revenues will not necessarily derive only from the deals that are made. Whatever the sources of revenue planned for and generated, they must cover costs.
11. There is no substitute for being able to assess whether a project can succeed (in its own explicit objectives) and then turning down any that don't reasonably have that prospect.
12. Even though there will be political implications to many decisions, they must be made without bowing to political pressure, whether local or other.

Some of these implications for effective operation are unexceptional for any financial institution. Others are specific to the community development function as it may be carried out in any organizational format.

### **The Time Perspective**

One last note: CED and development finance are not a short-term process. While progress can be made within relatively short periods of time, what has taken decades to create in an impoverished and marginalized community is not reversed in a few years merely by, say, some new forms of accessible credit—important as this may be as a starting point. Therefore, it is fair to say that Community Development Finance and CED are both strategies and frameworks for mobilizing and governing the allocation of resources; they are interdependent and linked in virtually all settings where durable progress is made to renew communities that have suffered economic and social marginalization.